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China's Currency Practices and "Currency Manipulation": The Power of Action in Inaction

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> *We have told Beijing that we alone know the true value of the dollar-yuan exchange rate and have the authority to unilaterally penalize Chinese companies for pricing their products using the official exchange rate. . . . [T]here is little evidence that a stronger yuan*[1] *would reduce the U.S. trade deficit with China or improve the jobs picture.*[2]

I. INTRODUCTION

In a turn of events over the past decade, the United States has seen an economic downturn both nationally and globally not experienced since the Great Depression.[3] At the center of this financial crisis is the high unemployment rate and crushing trade deficit.[4] Reports suggest more than 2.7 million jobs have been displaced due to outsourcing to the People's Republic of China ("China"), where wages are extremely low and the cost of doing business in China is significantly cheaper than in the United States.[5] Combined with China's government-controlled currency exchange rate, U.S.-produced goods are unable to compete with goods imported from China both in the United States and on an international level.[6]

On the other hand, China's economy has grown dramatically over the past decade,[7] resulting in a tremendous trade surplus over the United States.[8] In 2003, the U.S. Department of Commerce announced that the U.S. trade deficit with China was at $124 billion,[9] a twenty percent increase from the previous year.[10] And one decade later in 2013, the U.S. trade deficit with China has more than

1. "Yuan" is often used synonymously with Renmibi ("RMB"), meaning "The People's Money," the official currency of China. *See* Claus D. Zimmermann, *Exchange Rate Misalignment and International Law*, 105 AM. J. INT'L L. 423, n.1 (2011).

2. James A. Dorn, *China and the Truth About the Senate's Exchange Rate Oversight Act*, CATO INSTITUTE (Oct. 4, 2011), http://www.cato.org/publications/commentary/china-truth-about-senates-exchange-rate-oversight-act.

3. *Global Economic Crisis*, YALEGLOBAL ONLINE, http://yaleglobal.yale.edu/content/global-economic-crisis (last visited Jan. 13, 2013).

4. *See* Fred Moseley, *The U.S. Economic Crisis: Causes and Solutions*, INT'L SOCIALIST REV., Mar.-Apr. 2009, http://www.isreview.org/issues/64/feat-moseley.shtml.

5. Robert E. Scott, *The China Toll: Growing U.S. Trade Deficit with China Cost More Than 2.7 Million Jobs Between 2001 and 2011, with Job Losses in Every State*, ECON. POL'Y INST., http://www.epi.org/publication/bp345-china-growing-trade-deficit-cost/ (last visited Jan. 13, 2013).

6. *See* Arthur Pinkasovitch, *What a Rising Yuan Means for You*, FORBES (May 12, 2010, 1:40 PM), http://www.forbes.com/2010/05/12/yuan-currency-investing-personal-finance-yuan-investing.html.

7. *GDP Growth (Annual %)*, THE WORLD BANK, http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG (last visited Jan. 13, 2013).

8. *China*, OFF. OF THE U.S. TRADE REPRESENTATIVE, http://www.ustr.gov/countries-regions/china (last visited Jan. 13, 2013).

9. *Trade in Goods with China*, U.S. CENSUS BUREAU, http://www.census.gov/foreign-trade/balance/c5700.html (last visited Jan. 13, 2013).

10. *Id.*

doubled to a staggering $290.6 billion.[11] Many, including Robert E. Scott at the Economic Policy Institute,[12] have named "currency manipulation" as a major cause of the U.S.-China trade deficit.[13]

Beginning in 2003, a series of currency exchange rate bills to combat China's "currency manipulation" have been introduced to Congress.[14] On October 11, 2011, the U.S. Senate passed The Currency Exchange Rate Oversight Reform Act of 2011 ("Act") with a vote of 63-35.[15] The Act would allow the U.S. government to impose countervailing duties on Chinese goods if it deems that China is undervaluing its currency.[16] Its proponents claim that China's policies in interfering with the appreciation of its currency, along with its subsidies in certain growth industries, provide its domestic export industries with an unfair competitive advantage.[17] Thus, U.S. firms are forced to choose between outsourcing jobs and going out of business.[18] On the other hand, critics call the Act economic protectionism and a potential risk of a trade war with China, which is the last thing the United States wants during its financial crisis.[19] Similarly, China's foreign ministry spokesman, Ma Zhaoxu, believes the United States is "politicizing" the currency exchange issue and that if this bill passes, its enactment will be a "[grave violation of] the rules of the World Trade Organisation and severely upset China-U.S. economic and trade relations."[20] Despite its popularity in the Senate and its publicity in the media,[21] the Act failed

11. *Id.*

12. Scott, *supra* note 5; Michele Nash-Hoff, *U.S.-China Trade Deficit Cost More than 2.1 Million Manufacturing Jobs*, CAN AM. MANUFACTURING BE SAVED? (Sept. 4, 2012, 5:20 PM), http://savingusmanufacturing.com/blog/outsourcing/u-s-china-trade-deficit-cost-more-than-2-1-million-manufacturing-jobs/; *Trade Deficit with China has Cost 2.8 Million U.S. Jobs over Past Decade, New Study Finds*, AM. MANUFACTURING.ORG (Sept. 20, 2011), http://americanmanufacturing.org/press-releases/trade-deficit-china-has-cost-28-million-us-jobs-over-past-decade-new-study-finds.

13. Annie Lowrey, *A Tightrope on China's Currency*, N.Y. TIMES (Oct. 22, 2012), http://www.nytimes.com/2012/10/23/us/politics/romney-pledge-to-call-china-a-currency-manipulator-poses-risks-experts-say.html?_r=0; Daniel Barbeau, *China's Money Manipulation Will Backfire*, THE DAILY TITAN (Oct. 23, 2012), http://www.dailytitan.com/2012/10/chinas-money-manipulation-will-backfire/.

14. *See* H.R. 3269, 108th Cong. (2003); H.R. 3157, 109th Cong. (2005).

15. *S. 1619 Currency Exchange Rate Oversight Reform Act of 2011*, OPENCONGRESS, http://www.opencongress.org/bill/112-s1619/show (last visited Jan. 31, 2013); *see also Trade with China: And Now, Protectionism,* ECONOMIST (Oct. 15, 2011), *available at* http://www.economist.com/node/21532288.

16. Kathrin Hille, *China Warns of 'Trade War' over US Bill,* FIN. TIMES (Oct. 4, 2011), http://www.ft.com/cms/s/0/b97e8834-ee3a-11e0-a491-00144feab49a.html#axzz1bf3NjMCC.

17. Robert W. Staiger & Alan O. Sykes, *'Currency Manipulation' and World Trade*, 9 WORLD TRADE REV. 583, 584 (2010).

18. *See* Michele Nash-Hoff, *U.S. Lost 1.9 Million Manufacturing Jobs Due to Trade Deficit with China,* HUFFINGTON POST (Sept. 28, 2011), http://www.huffingtonpost.com/michele-nashhoff/us-china-trade-deficit_b_984374.html; *see also* Robert E. Scott, *Unfair China Trade Costs Local Jobs*, ECON. POL'Y INST. (Mar. 23, 2010), http://www.epi.org/publication/bp260/.

19. *Trade with China: And Now, Protectionism*, *supra* note 15.

20. Hille, *supra* note 16.

21. *See generally* Dorn, *supra* note 2; *see generally Trade with China: And Now, Protectionism*, *supra* note 15; *see generally* Jennifer Steinhauer, *Senate Jabs China Over Its Currency*, N.Y. TIMES (Oct. 11, 2011),

to gain traction in the House of Representatives and died without further progress.[22] However, given the continuing relevance of China's exchange rate policy on the rising U.S. trade deficit, a similar bill is likely to be introduced in current and future congressional sessions.

Notwithstanding the difference in opinion regarding the Act, there unquestionably exists a close relationship "between monetary policy and international trade."[23] Depending on how a country's central bank intervenes in foreign exchange markets, it can either stimulate or impede imports and exports.[24] China, for example, is under heavy criticisms by the United States for regularly intervening into its foreign exchange markets in order to prevent the RMB from appreciating relative to other currencies,[25] which has resulted in global trade surpluses[26] that are used to heavily subsidize its domestic industries.[27] However, International Monetary Fund ("IMF") policies require the United States to bring a formal complaint to the World Trade Organization ("WTO") to demonstrate how China's alleged "currency manipulation . . . materially injured" competing U.S. industries.[28]

Part II of this Comment discusses the current Chinese policies on foreign exchange and its effects on the United States' trade deficits and jobs. Part III examines the rules and regulations under IMF and WTO that govern the foreign exchange markets. Part IV looks at past efforts by the United States to implement domestic laws that regulate foreign exchange markets. Part V discusses the recent effort by the United States in combating China's "currency manipulation" and articulates how it changes current laws. Part VI then concludes that the United States may find the power of action in inaction, and that the Chinese government will likely change its own currency practices in the near future due to internal economic pressures.

http://www.nytimes.com/2011/10/12/business/senate-approves-bill-aimed-at-chinas-currency-policy.html.

22. *See S. 1619 (112th): Currency Exchange Rate Oversight Reform Act of 2011*, GOVTRACK.US, *available at* http://www.govtrack.us/congress/bills/112/s1619 (last visited Jan. 13, 2012).

23. Staiger & Sykes, *supra* note 17, at 583.

24. *Id.* at 583-84.

25. Robert E. Scott, *Currency Manipulation—History Shows that Sanctions are Needed*, ECON. POL'Y INST. (Apr. 29, 2010), http://www.epi.org/publication/pm164/.

26. *Id.*

27. *Id.*

28. Staiger & Sykes, *supra* note 17, at 584.

II. CHINA'S HISTORICAL AND CURRENT EXCHANGE RATE POLICIES AND THEIR EFFECTS ON THE UNITED STATES' TRADE DEFICITS AND JOBS

A. *China's Policies*

China regularly intervenes in its foreign exchange markets.[29] In an effort to control its currency exchange rates, China "pegs"[30] foreign exchange rates by either releasing currencies into the market to relieve excess demands or by purchasing exchange reserves to soak up excess supply.[31] On the contrary, other countries may choose to allow their currencies to "float"[32] and let their values to be determined by free market forces.[33] "Most of the major currencies, including the dollar, the Euro, the [Japanese] yen and the British pound, now float."[34]

Despite China's enormous growth in world trade over the years, the RMB does not float.[35] Prior to 1994, China employed a dual exchange rate system that consisted of an official fixed exchange rate system used by the government and a semi market-based system used by importers and exporters.[36] In 1994, the Chinese government combined the two exchange rate systems and pegged the RMB at 8.70 yuan to the dollar, which increased to 8.28 yuan to the dollar by 1997 and remained relatively constant until mid-2005.[37] China rationalized their approach as a need to provide a relatively stable environment for foreign trade and investment while its country was in its early developmental stages.[38]

In 2005, the Chinese government reformed its exchange rate system policies.[39] It announced that the RMB would no longer be pegged, and that the RMB exchange rate would become "adjustable based on market supply and demand with reference to exchange rate movements of currencies in a basket" containing various currencies of major developed countries.[40] The Chinese

29. Jim Saxton, *Chinese FX Interventions Caused International Imbalances Contributed to U.S. Housing Bubble*, *in* THE CHINESE ECONOMY 97 (Benjamin A. Tyler ed., 2010).

30. To "peg" a currency means to control the value of a currency through governmental actions.

31. Scott, *supra* note 25.

32. As oppose to "pegging" a currency, allowing a currency to "float" means to allow free market forces to determine the value of that currency.

33. Staiger & Sykes, *supra* note 17, at 587.

34. *Id.*

35. *Id.*

36. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 2 (2011).

37. *Id.*

38. *Id.*

39. *Id.*

40. *Spokesman of the People's Bank of China on the Reform of the RMB Exchange Rate Regime*, THE PEOPLE'S BANK OF CHINA, para. 7 (July 25, 2005), http://www.pbc.gov.cn/publish/english/955/2001/20015/20015_.html. However, the exact composition of the basket has never been revealed. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 2.

government believed a reform of the RMB exchange rate regime was necessary because while its trade surplus had continued to increase substantially, reaching $711 billion by the end of June 2005, it was experiencing intensifying trade frictions in the international arena.[41] Furthermore, China believed this new regime would help create a more sustainable economic development strategy that focused on domestic demand and the improvement of resource allocation.[42] The new regime aimed to preserve stability from the old regime while taking steps toward a more adaptive type of foreign exchange rate system that took into account the flow of foreign resources and markets.[43]

Following this reform, the exchange rate of RMB was immediately adjusted from 8.28 yuan to 8.11 yuan on the U.S. dollar.[44] Though the RMB would be allowed to fluctuate slightly in relations to the basket on a daily basis, China only allowed the RMB to appreciate at a very slow and steady pace.[45] From mid-2005 to mid-2008, the dollar-RMB exchange rate appreciated from 8.11 to 6.83,[46] an appreciation of 20.8 percent (if the initial adjustment from 8.28 to 8.11 yuan is included).[47] However, in response to the declining global demands for Chinese goods due their rising cost,[48] the Chinese government suspended its exchange rate regime in mid-2008 and the exchange rate was held relatively constant at 6.83 until mid-2010.[49] In mid-2010, The People's Bank of China decided to resume its RMB reform to "enhance the RMB exchange rate flexibility."[50] However, the Spokesperson cautioned against "any sharp and massive fluctuations of the RMB exchange rate," claiming "the RMB exchange rate is moving closer to its equilibrium level."[51] On January 14, 2013, the yuan-dollar exchange rate was 6.22.[52]

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41. *Spokesman of the People's Bank of China on the Reform of the RMB Exchange Rate Regime*, *supra* note 40.

42. *Id.*

43. *Id.*

44. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 2, 3.

45. *Id.* at 3.

46. *Id.* For clarification, appreciation of the dollar-RMB exchange rate represents a closer exchange rate gap between the dollar and the RMB. The closer the exchange rate is to zero, the more the RMB is worth on the exchange market in relations to the dollar.

47. *Id.*

48. An appreciation of RMB during 2005 to 2008 meant an increased in cost for U.S. consumers to purchase imported Chinese exports. This is caused by relative diminishment of the dollar's purchasing power on Chinese goods as yuan appreciated.

49. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 3.

50. *China Decides to Further Reform RMB Exchange Rate Regime*, XINHUA (June 19, 2010), http://news.xinhuanet.com/english2010/business/2010-06/19/c_13358433.htm.

51. *Spokesperson of the People's Bank of China Answers Questions on Further Reforming the RMB Exchange Rate Regime*, THE PEOPLE'S BANK OF CHINA (June 21, 2010), http://www.pbc.gov.cn/publish/english/955/2010/20100622144355378529746/20100622144355378529746_.html.

52. *Currency Calculator (US Dollar, Chinese Yuan Renminbi)—X-Rates*, X-RATES.COM, http://www.x-

B. Effects on the United States' Trade Deficits and Jobs

The effects on world trade due to government intervention into the foreign exchange market can be dramatic.[53] As a result of the Chinese government's intervention into RMB's foreign exchange rate in an effort to control its appreciation, Chinese goods are exported at a cheaper rate, requiring less foreign currency to purchase.[54] Conversely, its imports become more expensive, requiring more domestic currency to purchase foreign goods.[55]

Economists contend that the undervalued RMB has been a major factor in the fast-growing U.S. trade deficit with China, which has skyrocketed from $10 billion in 1990 to $273 billion in 2010.[56] Some even argue that there is a "direct correlation between the U.S. trade deficit and U.S. job losses, especially in the manufacturing sector."[57] The government-controlled exchange rate in China caused Chinese exports to be comparatively inexpensive and U.S. exports to China to be comparatively expensive.[58] Consequently, it became cheaper to purchase Chinese goods in the United States and more expensive to purchase U.S. goods in China.[59] As a result, the U.S. imports a much greater amount of Chinese goods to meet the demands of its consumers, but it is simultaneously unable to export an equivalent amount of U.S. goods to China due to the low demand from Chinese consumers.[60] Studies show that between 2001 and 2008, 2.4 million jobs were lost or displaced as a result of the U.S. trade deficit with China, and analysts believe an appreciation in RMB would result in a more equalized import and export market and help create jobs in U.S. export industries.[61]

Critics of China's policy have argued that while a pegged currency regime was appropriate while China was in its early stages of economic development, it is no longer necessary or justified given China's current economy and enormous growths in world trade.[62] In fact, China is the world's largest merchandise

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rates.com/calculator/?from=USD&to=CNY&amount=1.00 (last visited Jan. 14, 2013).

53. *See* WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 6-8.

54. Staiger & Sykes, *supra* note 17, at 587-88.

55. *Id.*

56. *Trade in Goods with China*, *supra* note 9.

57. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 8.

58. *Id*. at 29-30.

59. *Id*.

60. Tibita Kaneene, *Why China's Currency Manipulation Doesn't Matter*, FOREIGN POL'Y (Feb. 10, 2009), http://www.foreignpolicy.com/articles/2009/02/09/why_chinas_currency_manipulation_doesnt_matter.

61. Scott, *supra* note 18.

62. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 6.

exporter, accounting for approximately ten percent of global exports,[63] and China also became the world's second largest economy in 2010, surpassing Japan.[64] To prevent the RMB from appreciating, China accumulated official foreign reserves amounting to $3.3 trillion.[65] At the G-20 Meeting in South Korea on February 27, 2010, the IMF stated that the RMB was "assessed to be substantially undervalued from a medium-term perspective."[66] Estimates by various organizations and scholars have concluded that the RMB is undervalued by twelve to fifty percent.[67] With such alarming statistics, the United States first looked to find solutions from the International Monetary Fund and World Trade Organization.

III. INTERNATIONAL LAWS

A. *Bretton Woods System*

After World War II, a series of conferences resulted in the creation of the International Monetary Fund, the World Bank, and the General Agreement on Tariffs and Trade ("GATT").[68] The creations were known collectively as the Bretton Woods System.[69] The System was intended to prevent future economic crisis and to promote the values of capitalism.[70] A paramount concern during the Bretton Woods negotiations was the issue of free floating currencies and their potential detrimental effects on world trade.[71] The parties to the negotiations agreed to adopt fixed exchange rates and to accept the role of the IMF as the global enforcer of monetary policy.[72] Ironically, it was not until 1971 that the

63. WAYNE M. MORRISON, CONG. RESEARCH SERV., RS 33534, CHINA'S ECONOMIC CONDITIONS 18, 22 (2012) *available at* http://www.fas.org/sgp/crs/row/RL33534.pdf.

64. *Id.* at 10 (Economists predict China will overtake the U.S. as the world's largest economy in the next decade.); Jennifer Liberto, *Chinese VP: We Must Trust Each Other*, CNN MONEY (Feb. 13, 2012, 4:36 PM), http://money.cnn.com/2012/02/15/news/international/china_xi_jinping/index.htm.

65. Kenneth Rapoza, *How Much Longer Can China Accumulate Reserves?*, FORBES (May 29, 2012, 11:04 AM), http://www.forbes.com/sites/kenrapoza/2012/05/29/how-much-longer-can-china-accumulate-reserves/.

66. International Monetary Fund [IMF], *Global Economic Prospects and Policy Challenges*, at para. 5 (Feb. 27, 2010), *available at* http://www.imf.org/external/np/g20/pdf/022710.pdf.

67. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 17.

68. *Cooperation and Reconstruction (1944-71)*, INT'L MONETARY FUND, http://www.imf.org/external/about/histcoop.htm (last visited Jan. 13, 2013); M.J. Stephey, *A Brief History of Bretton Woods System,* TIME MAGAZINE (Oct. 21, 2008), http://www.time.com/time/business/article/0,8599,1852254,00.html; Understanding the WTO: Basics: The GATT Years: from Havana to Marrakesh, WTO, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm (last visited Jan. 19, 2013).

69. Stephey*, supra* note 68.

70. *See Cooperation and Reconstruction, supra* note 68.

71. *See* Benjamin J. Cohen, *Bretton Woods System*, BENJAMIN J. COHEN, http://www.polsci.ucsb.edu/faculty/cohen/inpress/bretton.html (last visited Jan. 13, 2013).

72. *See id.*

United States discarded its fixed exchange rate policy and floated the dollar.[73] Thus, while a major goal of the Bretton Woods Conferences was to encourage free trade and open market, stability remained the central theme.[74]

B. International Monetary Fund

IMF was created in 1945 to "oversee[] the international monetary system to ensure exchange rate stability and [to] encourag[e] members to eliminate exchange restrictions that hinder trade."[75] All countries that have their own currency, including the United States and China, are currently members of the IMF.[76] Up until the 1970s, the IMF implemented strict control over the exchange rate markets.[77] It was never imagined that a country would be able to peg its currency as opposed to being guided by market forces.[78] However, the IMF's rules were changed in 1978 so that it no longer governed world exchange rates.[79] Currently, the IMF's roles include handling global trade imbalances associated with "fundamental misalignment" or exchange rate "manipulation."[80] In 2007, the IMF explained the term "fundamental misalignment" as:

> When the underlying current account is not in equilibrium (which may be due to exchange rate policies but also to unsustainable domestic policies or to market imperfections), the exchange rate is "fundamentally misaligned." In other words, fundamental exchange rate misalignment, an important indicator of external instability under the 2007 decision, is a deviation of the real effective exchange rate from its equilibrium level–that is, the level consistent with a current account (stripped of cyclical and other temporary factors) in line with economic fundamentals.[81]

73. *China's Exchange Rate Policy Not Violate WTO*, CHINADAILY (Feb. 26, 2004, 3:54 PM), http://www.chinadaily.com.cn/english/doc/2004-02/26/content_309623.htm.

74. *See Cooperation and Reconstruction, supra* note 68.

75. History, INT'L MONETARY FUND, http://www.imf.org/external/about/history.htm (last visited Oct. 24, 2011).

76. JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 1 (2011).

77. *Id.* at 3.

78. *Id.*

79. *Id.*

80. *See generally* Sitikantha Pattanaik, *Global Imbalances, Tanking Dollar, and the IMF's Surveillance over Exchange Rate Policies*, 27 CATO J. 299 (2007), *available at* http://www.cato.org/sites/cato.org/files/serials/files/cato-journal/2007/11/cj27n3-1.pdf.

81. *Surveillance Guidelines: Landmark Framework for IMF Surveillance*, INT'L MONETARY FUND, BOX 1 (June 21, 2007), http://www.imf.org/external/pubs/ft/survey/so/2007/pol0621b.htm.

Furthermore, the IMF stated:

> The IMF's Articles of Agreement provide that member countries shall "avoid manipulating exchange rates . . . to prevent effective balance of payments adjustments or to gain an unfair competitive advantage over other member." But the Fund had provided little guidance on what constitutes such exchange rate manipulation. The 2007 Decision on Bilateral Surveillance that the IMF's Executive Board approved on June 15 provides guidance to the IMF's 185 member countries on that type of behavior that is at issue.
>
> The 2007 decision provides that a member would be "acting inconsistently with Article IV, Section 1 (iii)", if the Fund determined it was both engaging in policies that are targeted at–and actually affect–the level of exchange rate, which could mean either causing the exchange rate to move or preventing it from moving; and doing so "for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate" in order "to increase net exports."[82]

For three reasons, the bilateral surveillance process is unlikely to have much influence on the exchange policies of China.[83] First, a violation of Article IV, Section 1, is difficult to show.[84] Under the IMF interpretation of Article IV stated above, manipulation to obtain unfair advantage occurs only when a member engages in policies "for the purpose" of creating fundamental misalignment to secure an increase in net exports.[85] Traditionally, IMF has given incredible deference to sovereign countries and has not publicly challenged objectives statements put forth by countries that have exchange rate policies.[86] In determining intent, the member is given "the benefit of any reasonable doubt."[87] Therefore, China will surely rationalize their currency control as a means of economic stability and promotion of domestic economic growth through exports.[88]

82. *Id.*

83. *See generally* Michael Mussa, *IMF Surveillance over China's Exchange Rate Policy*, Paper presented at the Conference on China's Exchange Rate Policy, (Oct. 19, 2007), *available at* http://www.piie.com/publicatiorns/papers/mussa1007.pdf.

84. *Id.*

85. *Surveillance Guidelines*, *supra* note 81.

86. JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 1-2 (2011).

87. IMF, *Exchange Arrangements and Surveillance*, INT'L MONETARY FUND (Dec. 31, 2010), http://www.imf.org/external/pubs/ft/sd/index.asp?decision=13919-(07/51 [hereinafter *Exchange Arrangements and Surveillance*].

88. *See supra* Part II.

Second, even if China's policies are found to be in violation of Article IV, the history of bilateral surveillance suggests a strong preference in the IMF toward avoiding confrontation when powerful countries are involved.[89] The 2007 Board decision emphasizes that "[d]ialogue and persuasion" are key pillars of effective surveillance.[90] The IMF's "assessments and advice are intended to assist that member in making policy choices, and to enable other members to discuss these policy choices with that member."[91] In other words, the surveillance process is anything but adversarial, and much more grounded in persuasion and consensus.[92] Indeed, since Article IV was ratified three decades ago, the number of consultations sought under its provisions has reached over forty thousand.[93] Yet, "[i]n none of these consultations has the Executive Board ever concluded that a member was out of compliance with its obligations regarding its exchange rate policies or any other matter!"[94]

Finally, IMF has little practical leverage over a country like China.[95] In theory, members in violation of IMF provisions can be punished through a curtailment of their access to Fund resources, suspension, or even expulsions from membership.[96] However, the 2007 Board decision does not explicitly or implicitly mention that such sanctions will be deployed against violators of Article IV.[97] In practice, IMF may threaten to cut off IMF borrowings if a member does not pursue the appropriate policies.[98] China, however, has no need to borrow from the IMF and no prospect for such a need in the foreseeable future because it has trillions of dollars in foreign exchange reserves.[99] Simply put, China is "insulated from the Fund's criticism."[100] Although the 2007 Board Decisions allows IMF to exercise "firm surveillance" of inappropriate activities that result in fundamental misalignment or currency manipulation, IMF cannot compel a country to change its exchange rate.[101] In other words, the IMF can only attempt to persuade countries by offering economic advice and trying to convince

89. Staiger & Sykes, *supra* note 17, at 592-93.

90. *Surveillance Guidelines*, *supra* note 81.

91. IMF, *Selected Decisions and Selected Documents of the International Monetary Fund,* INT'L MONETARY FUND, Dec. 2011, at 37, *available at* http://www.imf.org/external/pubs/ft/sd/2012/123111.pdf.

92. Staiger & Sykes, *supra* note 17, at 592-93.

93. Mussa, *supra* note 83, at 40.

94. *Id.*

95. *See infra* note 74-81 and accompanying text.

96. *See* Articles of Agreement of the International Monetary Fund art. XXVI, July 22, 1944, 60 Stat. 1401, 2 U.N.T.S. 39 [hereinafter IMF Agreement].

97. *See Exchange Arrangements and Surveillance*, *supra* note 87.

98. Staiger & Sykes, *supra* note 17, at 593.

99. *Id.*

100. *Id.* (quoting H.R. Torres, *Reforming the International Monetary Fund—Why Its Legitimacy is at Stake*, 10 J. INT'L. ECON. L. 433, 450 (2007).

101. JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 2 (2011).

them that a change in exchange rate might be in their best interest.[102] But whether a country decides to change its policy is a decision that resides solely in that country alone.[103]

C. World Trade Organization

The World Trade Organization was established in 1995 with the aim to "provide[] a forum for negotiating agreements aimed at reducing obstacles to international trade and [to] ensur[e] a level playing field for all, thus contributing to economic growth development."[104] Both the United States and China are currently members of the WTO.[105] Unlike the IMF and other international trade and finance organizations, the WTO has a way to enforce its policies.[106] A country may file a complaint if it believes another country has violated WTO rules to its detriment, and argue their position in front of a dispute settlement panel.[107] The panel then renders its judgment, and "if the losing party does not comply with the ruling within a reasonable period of time, the WTO may . . . authorize it to impose retaliatory measures . . . against the offending country or to take other appropriate retaliatory measures against that country's trade."[108] This Comment explores two of the options under WTO law which the United States may utilize against China: a complaint based on the notion that China's policies constitute an impermissible export subsidy and a complaint based on GATT Article XV.[109]

1. Impermissible Export Subsidy

While WTO regulations expressly prohibit countries from providing subsidies to promote their national exports, it is heavily in dispute whether currency policies fall under the WTO's jurisdiction.[110] Under the Agreement on Subsidies and Countervailing Measures ("SCMs"), "subsidy" exists if "there is a financial contribution by a government involve[ing] a direct transfer of funds, [tax credits], or [assistance in] goods or services other than general

102. *Id.*

103. *Id.*

104. *About the WTO—A Statement by the Director-General*, WTO, http://www.wto.org/english/thewto_e/whatis_e/wto_dg_stat_e.htm (last visited Oct. 24, 2011).

105. *Members and Observers*, WTO, http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm (last visited Oct. 24, 2011).

106. JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 2.

107. *Id.*

108. *Id.* at 2-3.

109. *See infra* Part III.B.1-2.

110. JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 3.

infrastructure."[111] Furthermore, export subsidy is "contingent upon export performance"[112] and must be "specific to an enterprise or industry" and not be applicable to all producers.[113] Some argue that China's currency-induced subsidy is neither contingent on export performance nor specific to an industry.[114] Anyone who exchanges currency receives the same rate even if they are not exporting.[115] Others contend the alleged benefit of China's policy only benefits the export industry while actually disadvantaging the import industry and consumers, thus satisfying the definition of an export subsidy under WTO's rules.[116] For example, a recent countervailing duty petition filed by U.S. producers of flexible magnets against Chinese importers alleges that when China lowers the value of the RMB, it makes imports more expensive so that consumers may buy fewer U.S. products.[117] However, once again, Chinese exporters are not a direct beneficiary in this situation. For these reasons, an argument that China's policies confer an impermissible export subsidy seems problematic on numerous fronts.

2. *GATT Article XV*

As a condition of WTO membership, applicants are required to accept existing trade rules established by GATT.[118] Article XV, entitled "Exchanged Arrangements," contains nine paragraphs that would be the grounds for a possible WTO complaint.[119] Article XV, paragraph 4, states that members "shall not, by exchange action, frustrate the intent of the provisions of this Agreement."[120] One concern voiced at its drafting was over the meaning of "frustrating the intent of provisions," which led to an interpretive note being added to the GATT.[121] This note explains "that infringements of the letter of any

111. Agreement on Subsidies and Countervailing Measures art. 1.1, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 275 (1999), 1867 U.N.T.S. 14.

112. *Id.* at art. 3, note 4; JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 3.

113. Agreement on Subsidies and Countervailing Measures, *supra* note 111, at art. 2.1; JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 3 (2011), *available at* http://www.fas.org/sgp/crs/misc/RS22658.pdf.

114. JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 3.

115. *Id.*

116. *Id.*

117. Raw Flexible Magnets from China and Taiwan, Inv. Nos. 701-TA-452/731-TA1129/731-TA1130, USITC Pub. 3961 (Nov. 2007) (Preliminary).

118. *See The 128 Countries that had Signed GATT by 1994*, WTO, http://www.wto.org/english/thewto_e/gattmem_e.htm (last visited Feb. 10, 2012).

119. General Agreement on Tariffs and Trade 1994 art. XV, Apr. 15, 1994, 1867 U.N.T.S. 187, 33 I.L.M. 1153 [hereinafter GATT 1994].

120. *Id.* at art. XV(4).

121. JOHN H. JACKSON, WORLD TRADE AND THE LAW OF GATT 482 (1969).

Article of this Agreement by exchange action shall not be regarded as a violation of that Article, if, in practice, there is no appreciable departure from the intent of the Article."[122] This note caused many to believe that it is "highly unlikely, if not impossible, to enforce rights and obligations under Article XV(4)."[123] In fact, since the founding of the GATT in 1947, Article XV(4) has only come into practice once, in 1952.[124]

Under Article XV(4), there is a differentiation between whether the action is based on exchange action or based on trade action.[125] While there is little history in this area of the law, this differentiation was addressed in 1954 by a sub-group during a review session.[126] The sub-group found that "in many instances it was difficult or impossible to define clearly whether a government measure is financial or trade in character and frequently it is both."[127] The sub-group noted that the differentiation is in practice "based on the technical nature of government measures rather than on the effect of these measures on international trade and finance."[128]

China's exchange rate policy likely constitutes "exchange action." The drafters of Article XV intended the term to be very encompassing.[129] On the other hand, the language of "trade action" suggests that the "action" must be one of trade.[130] Although China's exchange rate policy has an obvious effect on its trade, the sub-group's notes puts emphasis on the "technical nature" of the policy, rather than the effect the policy has on trade balance.[131] Therefore, an action involving China's practice would likely be categorized as an exchange action in a WTO dispute.[132]

Whether or not China's exchange rate policy "frustrates the intent of the provisions"[133] of GATT is a sharply divided question among the commentators.[134] Unfortunately, "nothing in Article XV or elsewhere in GATT provides clear

122. GATT 1994, *supra* note 119, at annex 1, art. XV(4); JACKSON, *supra* note 121, at 482.

123. Bryan Mercurio & Celine Sze Leung, *Is China a "Currency Manipulator"?: The Legitimacy of China's Exchange Regime Under the Current International Legal Framework*, 43 INT'L LAW. 1257, 1288 (2009).

124. RAJ BHALA, MODERN GATT LAW: A TREATISE ON THE GENERAL AGREEMENT ON TARIFFS AND TRADE 1174 (2005).

125. WORLD TRADE ORGANIZATION, GUIDE TO GATT LAW AND PRACTICE 435 (6th ed. 1995).

126. *Id.*

127. *Id.*

128. *Id.*

129. Dukgeun Ahn, *Is the Contemporary Chinese Exchange-rate Regime "WTO Legal"?*, *in* THE US-SINO CURRENCY DISPUTE, NEW INSIGHTS FROM ECONOMICS, POLITICS AND LAW 1 (Simon Evenett ed., 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1605542.

130. *Id.* at 2.

131. *See id.*

132. Ahn, *supra* note 129.

133. GATT 1994, *supra* note 119, at art. XV(4)

134. *See* Ahn, *supra* note 129, at 2.

guidance . . . as to what sorts of exchange practices would frustrate its intent."[135] In fact, Article XV(4) has never been interpreted by the WTO, and no case law exists on the subject.[136]

In adjudicating a claim under Article XV, WTO dispute process defers to the IMF on certain issues.[137] Article XV(2) states that in all cases dealing with "problems concerning monetary reserves, balance of payments or foreign exchange arrangements," GATT members must consult with the IMF and "shall accept all findings of statistical and other facts presented by the Fund relating to foreign exchange . . . and shall accept the determination of the Fund as to whether action by a contracting party . . . is in accordance with the Articles of Agreement of the International Monetary Fund."[138] Thus, a violation of GATT Article XV depends on the existence of a violation of Article IV of the IMF Agreement.[139] And as previously discussed, an action under the IMF Agreement would be problematic in practice.[140]

D. Amending the Articles of the IMF or the WTO Agreements

Recalling the United States' limited options under existing IMF and WTO provisions, in addition to the problems presented by each other those options, amending existing IMF and WTO provisions could potentially lead to desirable outcomes.[141]

Amending the Articles of IMF, may restore, to some degree, the IMF's power over foreign exchange rates from 1946 to 1971.[142] However, two potential problems may arise. First, Article XXVIII of the IMF Agreement requires an eighty-five percent majority vote of IMF members for approval of amendments to the Articles.[143] "The majority of countries seem to believe that the present currency exchange system is working reasonably well and demonstrate little desire to amend current IMF rules."[144] Second, most countries would be hesitant to restore the IMF's previous strict powers over exchange rates because doing so essentially grants the IMF regulatory powers over all future matters concerning exchange rates. This could be interpreted as an intrusion into sovereign

135. *See* GATT 1994, *supra* note 119; *see also* Staiger &Sykes, *supra* note 17.
136. GATT 1994, *supra* note 119.
137. *See id.* at art. XV(2).
138. *Id.*
139. *Id.*
140. *See supra* Part III.B.
141. *See supra* Part III.B.
142. *See supra* Part III.B.
143. IMF Agreement, *supra* note 96, at art. XXVIII.
144. JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 8 (2011).

policymaking.[145] "For example, if the IMF is granted the power to declare China's RMB undervalued and to require appreciation, it would also have the power to declare the dollar or the euro overvalued and require the United States or European countries to adjust their domestic policies to depreciate the relative value of their respective currencies."[146]

Another option may be to amend WTO's current definition of export subsidy to include currency manipulation.[147] However, the amendment process basically requires the unanimous consent of all Members.[148] Countries that are accused of currency manipulation can easily prevent the amendment from passing.[149] Therefore, any change in the WTO provisions will likely be the result of bilateral or multilateral trade negotiations, where Members that believe currency "adjustment" is an acceptable trade practice can be persuaded to change their practices by other incentives.[150] Unable to overcome the hurdles necessary to amend IMF and WTO provisions, the U.S. government looked to find solutions in its domestic laws.[151]

IV. UNITED STATES' PAST EFFORTS

The Obama administration and the prior Bush administration have consistently favored diplomatic solutions in dealing with the currency dispute with China.[152] As a result, the respective administrations have not pursued any multilateral or unilateral trade measures.[153] While both administrations acknowledge that the RMB is significantly undervalued[154] and believes that the undervalued RMB results in trade detriment to the United States,[155] they also consider adversarial measures counterproductive.[156]

145. *Id.* at 5. The concern for overreaching power was the main reason the IMF's scope of regulation was limited. *See supra* Part III.A.

146. JONATHAN E. SANFORD, CONG. RESEARCH SERV., RS 22658, CURRENCY MANIPULATION: THE IMF AND WTO 5.

147. *Id.* at 6.

148. *Id.* at 5.

149. *Id.*

150. *Id.*

151. *See infra* Part IV.

152. *See generally U.S.-China Strategic and Economic Dialogue*, U.S. DEPARTMENT OF THE TREASURY (May 4, 2012), http://www.treasury.gov/initiatives/Pages/china.aspx.

153. *See* Karl Rusnak, *U.S. Sitting Back on Currency Manipulation Problem*, ECONOMY IN CRISIS (Nov. 15, 2011), http://economyincrisis.org/content/us-sitting-back-currency-manipulation-problem.

154. Chris Isidore, *China-U.S. Trade Wars: What's at Stake,* CNNMONEY (Oct. 13, 2011, 9:25 AM), http://money.cnn.com/2011/10/13/news/international/china_us_trade/index.htm.

155. *Id.*

156. *See id.*

A. Exchange Rates and International Economic Policy Coordination Act of 1988

The Exchange Rates and International Economic Policy Coordination Act, otherwise known as the Omnibus Trade and Competitiveness Act of 1988, gives the Treasury Department an oversight role that has not yet been employed to date.[157] The Act requires the Treasury Department to conduct annual evaluations of the exchange policies of foreign countries and determine whether those countries are "manipulating" their currency as defined under IMF Article IV(1).[158] If the Treasury Department deems such manipulation is present, it is then required to begin bilateral negotiations with the country at issue unless in doing so would threaten "vital national economic and security interests."[159] To date, the Treasury Department has declined to label China's exchange practices as currency manipulation.[160]

In 2007, a bill was proposed on Capitol Hill that would change the standard for finding manipulation under the 1988 Act.[161] The proposed law would require the Treasury Department to find manipulation by any foreign country with "material" global and "significant" bilateral trade surpluses in the event a country has practiced "prolonged one-way intervention in the currency markets."[162] Under the proposed standard, the Treasury Department would undoubtedly find China to be a currency manipulator and initiate bilateral negotiations under the 1988 Act.[163] However, the proposed legislation lacked bipartisan support due to a concern of a potential trade war with China and was abandoned.[164]

B. Countervailing Duties

As previously discussed, a country whose import-competing industries are threatened or "materially injured" by the export subsidization of another country has a right under current WTO provisions to impose countervailing duties to offset the injury.[165] However, U.S. law precludes the use of countervailing duties against exports from non-market economies.[166] Before 2007, the U.S. Department of Commerce labeled China as a non-market economy and reasoned that the

157. *See* 22 U.S.C. § 5304 (1998).

158. *Id.* § 5304(b).

159. *Id.*

160. Anna Yukhananov, *U.S. Declines to Name China Currency Manipulator*, REUTERS (Nov. 27, 2012, 5:42 PM), http://www.reuters.com/article/2012/11/27/us-usa-china-treasury-idUSBRE8AQ19V20121127.

161. Currency Reform and Financial Market Access Act of 2007, S. 1677, 110th Cong. (2007).

162. *Id.* § 102(a)(b)(2)(A)-(C).

163. *See id.*

164. *See id.*

165. *See* Agreement on Subsidies and Countervailing Measures, *supra* note 111, at art. 19.

166. TODD B. TATELMAN ET AL., CONG. RESEARCH SERV, RL 33976, UNITED STATES' TRADE REMEDY LAWS AND NON-MARKET ECONOMIES: A LEGAL OVERVIEW 5 (2007).

extent of entanglement in the intervention the Chinese government had in its market made it impossible to identify export subsidies.[167] However, in 2007, the Department of Commerce changed its position and found that China's economy had developed sufficiently for the application of countervailing duty law.[168] To clear up the legal uncertainties accompanying this shift in views, various bills have been proposed on Capitol Hill that would give the Department of Commerce the explicit authority to use countervailing duties against non-market economy.[169]

However, even if U.S. law allows countervailing duties in case of an economy such as China's, other problems still remain. First, as discussed earlier, it is unclear whether China's exchange practices can be considered to confer "subsidies" within the meaning of that term under WTO law.[170] Any decision by the United States to apply countervailing duties on that basis would likely result in a WTO challenge.[171] Likewise, it is unclear whether current U.S. antidumping law[172] can be interpreted in such a way as to treat China's currency practices as a counter-available subsidy, although some proposals in Washington aim to amend U.S. law to cover such currency practices.[173]

Second, countervailing duties are only available in situations in which subsidized import competition is "[causing] or threaten[ing] material injury" to a competing domestic industry.[174] Individual firms are required to bring costly cases in front of the U.S. International Trade Commission ("ITC") to establish material injury for any "industry" in which countervailing duties are sought.[175] Lastly, a "countervailing duty may do little to benefit on an import-competing industry."[176] Since a countervailing duty remedy will apply only to China in this case, it may have no benefits to the import-competing industry that is competing with imports from multiple foreign countries at approximately the same price.[177]

167. Coated Free Sheet Paper From the People's Republic of China: Amended Preliminary Affirmative Countervailing Duty Determination, 72 Fed. Reg. 17484-01 (Apr. 9, 2007).

168. *Id.*

169. *See, e.g.*, H.R. 708, 110th Cong. (2007); H.R. 1229, 110th Cong. (2007); H.R. 2942, 110th Cong. (2007); S. 364, 110th Cong. (2007); S. 974, 110th Cong. (2007).

170. *See supra* Part III.C.1.

171. *See supra* Part III.C.1.

172. Antidumping law refers to laws designed to prevent antidumping from foreign countries. Dumping occurs when foreign products are sold in the domestic market at "below cost," thereby diminishing the domestic producers' ability to remain competitive in the marketplace. *See infra* Part IV.C.

173. *See, e.g.,* H.R. 782, 110th Cong. (2007); H.R. 2942,110th Cong. (2007); S. 364, 110th Cong. (2007).

174. GATT 1994, *supra* note 119, at art. VI:6(a); Tariff Act of 1930,19 U.S.C. § 1671(a)(2), *available at* http://www.law.cornell.edu/uscode/text/19/1671.

175. Staiger & Sykes, *supra* note 17, at 614.

176. *Id.* An import-competing industry is "a domestic industry that produces the same or a close substitute good that competes in the domestic market with imports" of foreign goods. TURLEY MINGS & MATTHEW MARLIN, THE STUDY OF ECONOMICS: PRINCIPLES, CONCEPTS & APPLICATIONS ch. 15 (6th ed. 1999), *available at* http://www.mhhe.com/cls/econ/define.mhtml?CHAPTER=ch15.

177. Staiger & Sykes, *supra* note 17, at 614.

Therefore, it is unclear how many domestic firms would pursue a costly countervailing duty remedy from the U.S. International Trade Commission.[178]

For these reasons, commentators are skeptical of the viability of the countervailing duty option.[179] However, because countervailing duties are a unilateral policy that can be imposed without approval from the IMF or WTO, "[t]hey can be imposed for a significant amount of time without incurring any formal international sanction even if they would later prove to be illegal under WTO law."[180] The mere suggestion of countervailing duties may also pressure China to temporarily relax its currency policy.[181] Nevertheless, something as extreme as a blanket "tariff" on Chinese goods is unlikely to be imposed, and the United States may seek to amend its existing laws to combat the currency undervaluation in specific industries.[182]

C. United States' Anti-Dumping and Countervailing Duties on Certain Products from China

The United States has applied anti-dumping laws to maintain "fair pricing" for its imports for almost a century.[183] Consequently, the Tariff Act of 1930 ("Tariff Act") was amended to incorporate the international anti-dumping provisions to provide a legal basis for enforcement of such provisions in the United States.[184]

Dumping occurs when imported goods are sold below fair market value,[185] either causing, or threatening to cause, material injury, to the domestic industry producing similar products.[186] The Tariff Act provides that the United States shall investigate possible dumping practices by foreign companies and impose additional duties to offset any pricing disadvantages suffered by the domestic industry.[187]

Anti-dumping investigations may be petitioned by a domestic industry.[188] The investigatory responsibilities are shared between the ITC and the U.S. Department of Commerce ("DoC").[189] The DoC investigates whether certain sales are below fair market value, and the ITC investigates whether there has been

178. *Id.*

179. *Id.*; *see also* Zimmermann, *supra* note 1, at 457.

180. Staiger & Sykes, *supra* note 17, at 614.

181. Zimmermann, *supra* note 1, at 457.

182. *See infra* Part IV.C.

183. *See* Joseph A. Laroski, Jr., *NMES: A Love Story, Nonmarket and Market Economy Status Under U.S. Antidumping Law,* 30 L. & POL'Y INT'L BUS. 369, 372 (1999).

184. 19 U.S.C. § 1671 (2004).

185. 19 U.S.C. § 1677(34) (2004).

186. *Id.* § 1677(7).

187. *See id.* § 1671.

188. *Id.* § 1671(a).

189. 19 U.S.C. § 1673 (2004).

material injury to the domestic industry.[190] If both agencies find in the affirmative, the DoC issues an anti-dumping duty order to impose a countervailing duty in a percentage equal to the average amount by which the foreign market value exceeds the domestic price.[191]

Similar to countervailing duty, anti-dumping remedy will only be allowed in industries where material injury can be established, and where individual firms are willing to bring expensive cases in front of the DoC and ITC.[192] This unilateral option is also highly problematic under WTO law.[193] Dumping occurs at the firm-level when exporting firms sell goods at a lower price to foreign markets, or when goods are sold "below cost."[194] Under China's currency policy, the behavior of its exporting firms simply does not meet the dumping definition.[195] A great illustration is provided in Robert W. Staiger and Alan O. Sykes' article, *'Currency Manipulation' and the World Trade*:

> Suppose that a Chinese firm sells a widget for 10 RMB at home (F.O.B.), and sells an identical widget in the United States for 10 RMB at home (F.O.B.). From the firm's perspective, it has realized identical amounts from each transaction, but under the proposed legislation, the "export price" would be found to be less than the "normal value" [because the United States considers the Chinese RMB to be undervalued.][196]

A finding of "dumping" under these circumstances would both pervert the concept of antidumping and also violate the WTO Antidumping Agreement.[197] The agreement "provides that when the comparison requires a conversion of currencies, the exchange rate shall be the 'rate of exchange on the date of sale.'"[198] This language can be read to refer to the actual exchange rate of the market at the date of comparison, not what the United States deems to be the "real" exchange rate for the dollar-yuan.[199]

The methods used by the U.S. Department of Commerce to determine antidumping had also caught a great deal of criticism by supporters of noninterventionist free trade.[200] Critics argue that there is a disconnect between

190. *Id.*

191. *Id.*

192. Staiger & Sykes, *supra* note 17, at 615.

193. *Id.*

194. *Id.*

195. *Id.*

196. *Id.*

197. Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, annex 1A, art. 2.4, *available at* http://www.wto.org/english/docs_e/legal_e/19-adp_01_e.htm; Staiger & Sykes, *supra* note 17, at 615.

198. Staiger & Sykes, *supra* note 17, at 615.

199. *Id.*

200. Brink Lindsey, *The U.S. Antidumping Law: Rhetoric versus Reality*, CATO INST., 1 (Aug. 16, 1999),

the evidence supporting antidumping laws and the reality of antidumping practice.[201] Specifically, the laws as currently written and enforced do not reliably identify either price discrimination or below-cost sales.[202] One study shows that only one of the five different calculation methodologies used by the Department of Commerce has any relevance in determining price discrimination, and only two of the 107 affirmative dumping findings used to support U.S. antidumping law relied exclusively on this methodology.[203] The study further criticizes the Department of Commerce for not differentiating between price discrimination and below-cost sales resulting from government interventionism and from perfectly normal marketplace behavior.[204] Lastly, the study argues that the antidumping law unfairly punishes foreign firms for business practices routinely engaged in by American firms.[205] With no support from the international laws and current domestic laws, the U.S. Congress looks to enact new legislation that would enable its government to unilaterally punish China's currency practices.

V. THE CURRENCY EXCHANGE RATE OVERSIGHT REFORM ACT OF 2011

The Currency Exchange Rate Oversight Reform Act, first introduced in Congress in 2007, then again in 2009, 2010, and 2011, marked the efforts by the United States to enact legislation that would allow it to combat currency manipulation on the open market.[206] Its most recent version, the Currency Exchange Rate Oversight Reform Act of 2011, was the only one of the four that was successfully introduced in one of the congressional houses.[207] Despite passing the Senate, the bill received no attention from the House of Representatives and eventually died.[208] Nevertheless, since China's exchange rate policy remains a hot topic in Washington, its content remains relevant as a framework for future currency oversight acts.

A. *How Does the Law Change with Currency Exchange Rate Oversight Reform Act?*

Under existing U.S. trade law, countervailing duties can only be imposed on imported goods from countries that had been deemed a currency manipulator by

available at http://www.freetrade.org/pubs/pas/tpa-007.pdf.

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.*

206. *See, e.g.,* S. 1607, 110th Cong. (2007); S. 3134, 111th Cong. (2010); S. 1254, 111th Cong. (2011); S. 1619, 112th Cong. (as passed by Senate, Oct. 11, 2011).

207. *See generally* S. 1607; S. 3134; S. 1254; S. 1619.

208. S. 1619.

the Department of Commerce and International Trade Commission.[209] Though the Department of Commerce already has authority under current U.S. trade law to investigate whether currency undervaluation by a foreign government provides a counteravailable subsidy, it is not required to put forth such investigation at the request of U.S. industries.[210] And as previously discussed, the standard for counteravailable subsidy under current U.S. trade laws has not yet been successfully applied to any country and will not likely be applicable to China's currency practices.[211]

However, the Currency Exchange Rate Oversight Reform Act of 2011 changes how counteravailable subsidy is defined. Similar to current laws, the bill would allow the U.S. government to "treat currency manipulation as an unfair subsidy and an illegal trade practice, allowing countervailing duties to be imposed on" imported products from countries manipulating their currencies to prevent those products from flooding the domestic market.[212] However, the bill repeals the currency provisions in current law and replaces them with a new framework based on objective criteria.[213]

First, the bill requires the U.S. Treasury to identify misaligned currencies on the market and develop biannual reports to Congress.[214] On the report, misaligned currencies are either put in a "general category of 'fundamentally misaligned currencies' based on observed objective criteria," or "'fundamentally misaligned currencies for priority action' that reflects misaligned currencies caused by clear policy actions by the relevant government."[215] The Treasury is then required to seek advice from the International Monetary Fund and key trade partners about countries with "priority" currencies.[216] Countries with "priority" currencies are then given 360 days to correct the misalignment, and if the misalignment is not corrected, unilateral actions may be taken.[217] Second, the bill now *requires* the Department of Commerce to investigate a foreign government for currency undervaluation if a U.S. industry requests investigate and provides the proper documentation.[218] Lastly, the bill eliminates the bright-line rule that exists under the current law, which precludes the Department of Commerce from finding a counteravailable subsidy unless the subsidy benefits only the export industry of

209. *See supra* Part IV.B.

210. S. 1619 § 11(b)(A).

211. *See supra* Part IV.

212. Judith Wallner, *Currency Exchange Rate Oversight Reform Act—S. 1619 Legislative Bulletin,* DEMOCRATIC POL'Y & COMM. CENTER (Oct. 3, 2011), http://dpc.senate.gov/docs/lb-112-1-27.pdf.

213. S. 1619 §§ 11(b)(A), 15.

214. *Id.* § 4(a).

215. *Id.* § 4.

216. *Id.* § 5.

217. *Id.* § 7.

218. *Id.* § 11.

that country.[219] This bright-line rule was one of the hurdles that the Department of Commerce had in dealing with China, because China's currency exchange practices applied to all industries, though it mostly benefited the export sector.[220] Supporters of the bill claim that by revaluing Chinese currency, the bill could create more than two million U.S. jobs and boost the U.S. economy by nearly $300 billion in less than two years.[221] Despite its supporters' optimism and its overwhelming support in the Senate, the bill caught tremendous backlash just days after its success in the Senate.

B. The End of Future Currency Oversight Acts?: The United States-South Korea Free Trade Agreement

"South Korea is currently the United States' seventh-largest trading partner and eighth-largest export market" importing $37.587 billion and exporting $29.085 billion from January to August of 2011.[222] On October 12, 2011, the U.S. Congress approved the U.S.-Korea Free Trade Agreement ("FTA") with an overwhelming majority in the Senate (83-15) and a strong majority in the House of Representatives (278-151).[223] First signed by the Bush administration in 2007 and re-proposed by President Obama on October 3, 2011, the FTA was said to boost domestic employment and expand commerce with South Korea.[224] Economic experts believe the FTA was designed to "reduce the cost of U.S. goods and services exported to foreign markets, and also reduce the cost of foreign goods and services imported into the United States, which makes for greater trading parity."[225]

Prior to the implementation of the FTA, only thirty-eight "percent of U.S. tariff lines[226] and [thirteen] percent of Korean tariff lines . . . have free rates of duty."[227]

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219. *Id.* § 4.

220. *See supra* Part III.B.1.

221. Wallner, *supra* note 212.

222. Merie David Kellerhals, *Congress Approves U.S.-Korea Free-Trade Agreement*, IIP DIGITAL (Oct. 13, 2011), http://iipdigital.usembassy.gov/st/english/article/2011/10/20111013104630elrem0.9921686.html#axzz1jbl6jGBX.

223. *Id.*

224. Press Release, The White House, Office of the Press Secretary, Statement from President Obama on the Submission of the Korea, Columbia, and Panama Trade Agreements (Oct. 3, 2011), *available at* http://www.whitehouse.gov/the-press-office/2011/10/03/statement-president-obama-submission-korea-colombia-and-panama-trade-agr.

225. Kellerhals, *supra* note 222.

226. Tariff line is the product code used at the national level. It is important to note that 38% of tariff lines does not equate to 38% of all imported or exported goods, but instead represents 38% of all different types of goods.

227. U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects, Inv. No. TA-2104-24, USITC Pub. 3949 (Sept. 2007) (Final).

> Upon implementation . . . , more than [eighty-two] percent of U.S. tariff lines and more than [eighty] percent of Korean tariff lines would have free rates of duty . . . [and] [a]pproximately [ninety-nine] percent of U.S. tariff lines and 98 percent of Korean tariff lines would have free rates of duty" within ten years after implementation.[228]

Although the projected GDP increase in the United States is a mere 0.1 percent, the U.S. textiles and apparel sector, as well as the passenger vehicles sector, are expected to experience an import increase of eighty-five to ninety percent and fifty-five to fifty-seven percent, respectively.[229] The FTA also represents the strengthening political ties between the United States and South Korea.[230] President Obama has said that this agreement "is also a win for the strong alliance between the United States and South Korea, which for decades has ensured that the security that has maintained stability on the peninsula continues."[231]

The congressional approval of the FTA just nine days after the U.S. Senate passed the Currency Exchange Rate Oversight Reform Act of 2011 sparked tremendous backlash with the Chinese government and economic analysts all over the world.[232] One popular Chinese newspaper dubbed this apparent contradiction as the "coexistence of liberalistic and protectionist approaches" in the United States.[233] Jeong Young-sik, a senior research fellow at the Samsung Economic Research Institute, said "the bills are about politics as well about economics."[234] He argues that the U.S. Senate's support of the bill was caused by a need to persuade voters into believing that the economic downturn and high unemployment rate resulted from external factors such as the trade deficit with China.[235] From an economic perspective, Jeong believes it was a mistake to support South Korea over China, as China has a greater trade surplus with the United States and there is little room in South Korea for additional stimulus policies due to the size of its economy.[236] Furthermore, others believe the United States is taking a "misguided approach" with China in its attempt to impose punitive tariff on Chinese goods.[237] "Statistics showed that the Chinese Renminbi [RMB] has appreciated more than [thirty] percent against the U.S. dollar since

228. *Id.*

229. *Id.*

230. Kellerhals, *supra* note 222.

231. *Id*.

232. *See* Yoo Seungki, *Coexistence of liberalism and protectionism in U.S.*, XINHUA (Oct. 14, 2011), http://news.xinhuanet.com/english2010/indepth/2011-10/14/c_131192137.htm.

233. *Id.*

234. *Id.*

235. *Id.*

236. *Id.*

237. *Id.*

2005 . . . [and] [o]ver the same period, the U.S. . . . [unemployment] rate has risen from [seven] percent to [nine] percent . . . ."[238] Economists argue such statistics indicate that the RMB's value has little to do with the U.S. unemployment rate, and demanding the RMB to further appreciate will not produce the opposite result.[239]

VI. THE POWER OF ACTION IN INACTION

Many news articles and scholarly reports label China as a "currency manipulator" and call for unilateral actions from the United States to equalize the competitive edge that Chinese exporters have gained through China's foreign exchange rate regime.[240] However, opponents to this view (though not necessarily supporters of China's policy) forward three arguments contending that no unilateral actions should be pursued by the United States against China.[241]

First, the opponents argue that the United States simply has no control over what China does with its foreign exchange policies.[242] Under IMF and WTO rules, countries cannot unilaterally impose domestic policies with the aim to affect or control another country's currency exchange rate.[243] If the United States were to take unilateral actions, such as imposing a tariff using The Currency Exchange Rate Oversight Reform Act of 2011, China could successfully bring a complaint against the United States at the WTO.[244]

Second, even if the United States is able to force the appreciation of the RMB, the result may be the opposite of what U.S. policymakers want.[245] The undervalued RMB allows China to export Chinese goods to the United States at "relatively inexpensive" rates, enabling U.S. consumers to increase their consumption and purchasing power.[246] Likewise, certain U.S. producers import from China to produce finished goods for sale, and these producers are able to take advantage of the undervalued RMB to both lower the price of these products and remain more competitive in the marketplace.[247] As a result, appreciating the RMB could result in an increase in the price of China-made consumer products and U.S.-made products that use imported Chinese parts, leaving consumers with

238. *Id.*

239. *Id.*

240. Dustin Ensinger, *Currency Manipulation Undermining U.S.*, ECON. IN CRISIS (Feb. 19, 2010), http://economyincrisis.org/content/currency-manipulation-undermining-us; Scott, *supra* note 25.

241. *See* Kaneene, *supra* note 60; *And Now, Protectionism*, *supra* note 15.

242. *Good to Know One's Limits*, ECONOMIST (Mar. 25, 2010), http://www.economist.com/blogs/freeexchange/2010/03/chinas_currency_7.

243. *And Now, Protectionism*, *supra* note 15.

244. *Id.*

245. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 24-27 (2011).

246. *Id.* at 25.

247. *Id.*

"less money to spend on other goods and services" while also making certain U.S. producers less competitive.[248] Furthermore, the undervalued RMB provides incentive for the Chinese government and Chinese investors to purchase U.S. Treasury securities and other U.S. assets.[249] This demand results in the lowering of interest rates, which benefits U.S. borrowers, as well as funds the U.S. federal budget deficits.[250] China currently holds approximately $1.16 trillion in U.S. Treasury securities, which makes it the United States' largest foreign holder of such securities, with 25.7 percent of total foreign holdings.[251] An appreciation of the RMB may lessen the need for China to purchase U.S. Treasury securities and result in an increase of U.S. domestic interest rates.[252] In the "worst case scenario," if China stops purchasing securities when the federal budget deficit is unusually high, "it could destabilize financial markets by throwing into doubt the U.S. government's ability to sustain its current fiscal policy."[253]

Lastly, some analysts believe the problem will correct itself as China will soon be inclined to allow the RMB to appreciate at its own volition due to its own domestic demands.[254] Before discussing why China will be inclined to allow the RMB float, it is important to revisit the purpose behind China's policy. The Chinese government justifies their policies by arguing that their currency regime "foster[s] economic stability through currency stability . . . [and] reflects the government's goal of using exports as a way of providing jobs to Chinese workers and to attract [foreign direct investments] in order to gain access to technology and know-how."[255] However, critics contend that China's policy of focusing on export growth and currency control actually negatively impact China's economy.[256] First, China's currency policy may create an overdependence on exports.[257] A study by the IMF estimated that exports accounted for over sixty percent of China's GDP in the last decade, an increase of twenty percent from the previous decade.[258] Even China's former Premier,

248. *Id.*

249. *Id.* at 26.

250. *Id.*

251. *China's Holding of U.S. Debt Revised Up to 1.16 Trillion Dollars*, XINHUA (Mar. 03, 2011), http://news.xinhuanet.com/english2010/business/2011-03/01/c_13754563.htmhttp://news.xinhuanet.com/english2010/business/2011-03/01/c_13754563.htm; WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 26.

252. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 26.

253. *Id.*

254. Kaneene, *supra* note 60; *And Now, Protectionism*, *supra* note 15; Anatole Kaletsky, Op-Ed, *Blaming China Won't Help the Economy*, N.Y. TIMES (Sep. 26, 2010), http://www.nytimes.com/2010/09/27/opinion/27kaletsky.html?pagewanted=all.

255. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 28.

256. *Id.* at 29-31.

257. *Id.* at 29.

258. *Id.*

Wen Jiabao, recognized this problem when he stated "the biggest problem with China's economy is that the growth is unstable, unbalanced, uncoordinated, and unsustainable."[259] Second, an undervalued RMB makes foreign goods more expensive for both Chinese producers and consumers.[260] By benefiting the export industry at the expense of other industries, China may find itself unable to efficiently allocate and utilize its economic resources, with the majority of the resources being diverted to the export section.[261] Furthermore, China's policy is in effect "subsidizing American living standards by selling products that are less expensive than they would be under market conditions."[262] Consequently, Chinese consumers have to pay more for foreign goods because their currency is undervalued and has lower purchasing power in the marketplace.[263]

Finally, using a pegged exchange regime severely limits China's ability to raise interest rate to control inflation.[264] By purchasing U.S. Treasury securities, China "must first convert yuan to dollars, thereby releasing more Chinese currency" into the market, increasing inflation.[265] This increase in interest rate will entice foreign investors to transfer funds into the Chinese market, thereby forcing the central government to purchase more foreign currencies to soak up excessive supply.[266] Though the People's Bank of China ("PBOC") is trying to counterbalance this inflation by simultaneously selling PBOC bonds to soak up the excess yuan in the market, the process had not been especially effective.[267] Furthermore, PBOC bonds have relatively high interest rates, about 5.31 percent,[268] while U.S. Treasury securities have an interest rate near zero for short term investments.[269] As China continues to purchase more U.S. Treasury securities and sell more PBOC bonds to foreign investors, it becomes increasingly difficult for the Chinese government to maintain its current policy.[270] As a result, China has experienced incredible fluctuations in inflation rates from

259. Jahangir Aziz & Steven Dunaway, *China's Rebalancing Act*, FIN. & DEV., Sept. 2004, *available at* http://www.imf.org/external/pubs/ft/fandd/2007/09/aziz.htm.

260. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 29-30.

261. *Id.* at 30.

262. *Id.*

263. *Id.*

264. *Id.*

265. Kaneene, *supra* note 60.

266. WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV., RS 21625, CHINA'S CURRENCY POLICY: AN ANALYSIS OF THE ECONOMIC ISSUES 30.

267. Kaneene, *supra* note 60.

268. *Id.*

269. *Daily Treasury Yield Curve Rates*, U.S. DEPARTMENT OF THE TREASURY, http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield (last visited Oct. 24, 2011) (indicating an interest rate of less than 1% for investments up to five years and approximately 0.1% for investments up to one year).

270. Kaneene, *supra* note 60.

2009 to 2011.[271] These fluctuations translate into rising food prices, an increase of 13.4 percent from September 2010 to September 2011, which proves to be especially taxing on Chinese consumers.[272] These negative effects support the view that China will be compelled to appreciate its currency in the coming years due to market forces.[273] Therefore, it would be wiser for the United States to simply let China's currency situation work itself out, instead of attempting to unilaterally sanction China.[274]

VII. CONCLUSION

A brief look at China's economic growth over the three decades provides undisputable proof that its economic policies worked, and worked far better than any other country in the world in that same period of time.[275] However, this unprecedented rate of growth is not without its consequences.[276] By pegging its currency exchange rate and not allowing it to appreciate and depreciate with market forces, the Chinese government disproportionately benefited its export sectors at the expense of its own domestic consumers.[277] And while its export sectors experienced tremendous growth and China's foreign exchange reserve is now the largest in the world at $3.3 trillion (forty-six percent of the world's total national reserves),[278] its domestic consumers are left with an undervalued currency that has less purchasing power than what it is actually worth.[279] With uncontrollable price fluctuations in the domestic market, China looked for ways to shed its dependency on foreign currencies for importing foreign commodities.[280]

On December 25, 2011, China and Japan announced plans to promote the direct exchange of their currencies.[281] This agreement will allow firms to convert the Chinese and Japanese currencies directly into each other, bypassing the need

271. *The World Factbook: China (Economy)*, CENT. INTELLIGENCE AGENCY (Oct. 18, 2011), https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html (stating China's inflation rate for 2009 is -0.7% and 3.2% for 2010); *China's Inflation Rate Eases Further in September*, BBC NEWS (Oct. 14, 2011), http://www.bbc.co.uk/news/business-15302091 (stating China's inflation rate is at 6.1% in September, 2011).

272. *China's Inflation Rate Eases Further in September*, *supra* note 271.

273. Kaneene, *supra* note 60.

274. *Id.*

275. Horace Campbell, *China and Japan Currency Swap: Nail in US Dollar's Coffin*, EURASIA REV. (Jan. 27, 2012), http://www.eurasiareview.com/27012012-china-and-japan-currency-swap-nail-in-us-dollars-coffin-oped/ (discussing how China is averaging over 10% growth annually, making their economic transformation the most successful in the recorded history of political economy).

276. *See supra* Part VI.

277. *See supra* Part VI.

278. *The World Factbook, supra* note 271.

279. *See supra* Part VI.

280. *See supra* Part VI.

281. Campbell, *supra* note 275.

to use dollars.[282] Under the current foreign exchange policies, governments and firms that wish to purchase commodities must first exchange their individual currencies to foreign currencies.[283] This exchange results in transaction costs that can be avoided by purchasing and selling commodities using the global reserve currency held by the two countries, which is currently dominated by the dollar – accounting for more than sixty percent of the global foreign exchange reserves.[284] Although Japan is not the only country China has a currency swap agreement with, Japan is currently the world's third largest economy—just behind the United States and China—and China's biggest trading partner.[285] This alarming trend of major economies, especially in Asia, now adopting currency swap agreements to shed the Western dollar influence is said to be the "end of dollar hegemony" and the start of a "new international financial architecture" with the Chinese RMB soon becoming an internationalized currency.[286] This shift in the international financial architecture suggests that China has incentives to allow its currency to appreciate, at least to a certain extent, in order establish the RMB as a global exchange currency.[287]

The United States should avoid seeking to unilaterally impose countervailing duties on Chinese goods, as it will damage both its foreign relations with China and hurt its domestic consumers.[288] Furthermore, without support from the IMF and WTO, unilateral actions by the United States are subjected to attack in the international community and to claims through the WTO.[289] Instead, the United States should look to correct its own domestic economic policies to allow its own domestic industries to be more competitive in the open market.[290] With respect to China, the power of action may lie in the United States' inaction.

282. *Id.*

283. *Id.*

284. *Id.*

285. *Id.*

286. *Id.*

287. Jin Jing, *Why China's EMB Must Appreciate Further*, EPOCH TIMES (July 28, 2011), http://www.theepochtimes.com/n2/china-news/why-chinas-rmb-must-appreciate-further-59617.html.

288. *See supra* Part III.

289. *See generally* WAYNE M. MORRISON & MARC LABONTE, CONG. RESEARCH SERV. RL 32165, CHINA'S CURRENCY: ECONOMIC ISSUES AND OPTIONS FOR U.S. TRADE POLICY (2008).

290. *See generally id.*